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## The Great Inflation

Forthcoming in Anselm Doering-Manteuffel, Lutz Raphael, and Thomas Schlemmer (eds.), *Vorgeschichte der Gegenwart. Dimensionen des Strukturbruchs nach dem Boom* (Göttingen: Vandenhoeck & Ruprecht, 2015).

### 1. After the Great Moderation

As the 20th century ended, a reappraisal began of the 1970s as a crucial turning point in modernity. For some historians the 1970s were marked as the moment “after the boom”<sup>1</sup>. For others the epoch was defined by the “Shock of the Global”<sup>2</sup>. For cultural historians it was an age of fragmentation<sup>3</sup>. The 1970s were clearly an age of economic crisis, but this too could be understood in different ways. Deindustrialization and the end of Fordism were two options<sup>4</sup>. Globalization another<sup>5</sup>. The discovery of the limits to growth provided a resonant phrase to announce the environmental age. But, for economists and policy-makers, the 1970s stood for another type of epochal break, a revolution in monetary affairs. The end of Bretton Woods between 1971 and 1973 marked the universalization of fiat money. From the 1970s onwards, for the first time since the invention of money, nowhere, anywhere in the world was money directly anchored on gold. How would monetary systems be managed without this anchor? What would be tested in the 1970s and 1980s was a fundamental institutional question of the modern world:

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<sup>1</sup> Anselm Doering-Manteuffel/Lutz Raphael, *Nach dem Boom. Perspektiven auf die Zeitgeschichte seit 1970*, Göttingen, Third Edition, 2012.

<sup>2</sup> Niall Ferguson et al. (Eds.), *The Shock of the Global. The 1970s in Perspective*, Cambridge (Mass.)/London 2010.

<sup>3</sup> Daniel T. Rodgers, *Age of Fracture*, Cambridge (Mass.)/London 2011.

<sup>4</sup> Paul Hirst/Jonathan Zeitlin, “Flexible specialization versus post-Fordism: theory, evidence and policy implications,” in: *Economy and Society* 20 (1991) H. 1, 1-51, here 5-9; Jefferson Cowie, *Stayin’ Alive. The 1970s and the Last Days of the Working Class*, New York 2012; Judith Stein, *Pivotal Decade. How the United States Traded Factories for Finance in the Seventies*, New Haven 2010.

<sup>5</sup> Williamson and his NBER backed collaborators recast the economic history of the 19th and 20th centuries as a drama of globalization interrupted between 1914 and the 1970s. This narrative framed Kevin O’Rourke and Jeffrey Williamson’s *Globalization and History. The Evolution of a Nineteenth-Century Atlantic Economy*, Cambridge (Mass.)/London 1999. Summarizing the conventional narrative amongst economists, see Michael D. Bordo, “Globalization in Historical Perspective. Our Era is not as Unique as We Might Think, and Current Trends Are not Irreversible,” in: *Business Economics* 37 (2002) H. 1, 20-29.

the relationship between capitalism, fiat money and democratic policy-making. This question acquired an additional edge and urgency because the move to floating fiat currencies coincided with something else unprecedented, a sharp acceleration of inflation in peacetime. The datasets routinely used in economic research at the time immediately conveyed a sense of the historical significance of the event<sup>6</sup>. In two centuries of modern economic history, the inflations that set in during the early 1970s were the worst ever experienced outside wartime or postwar conditions. The only comparison was the monetary instability that wracked Latin America from the 1950s.

In some ways the crisis of capitalist governance in the West was a mirror image of that afflicting the ailing regimes of the Soviet bloc<sup>7</sup>. The reaction, however, was different. Whereas the Communist regimes continued to borrow abroad and repress dissent at home, Western Europe and the United States underwent regime change. By the mid 1980s the inflationary threat was conquered. If the end of the 20th century witnessed the defeat of Communism and the end of the Cold War, that victory would not have been so sweet if democratic capitalism had not made peace with itself. Nothing indicated that pacification more clearly than the triumphant narrative of the “conquest of inflation”. In the so-called Great Moderation proclaimed by none other than Ben Bernanke in 2004, it was claimed that policy-makers and their advisors had found a new and stable synthesis of markets and minimal, rule-bound government intervention<sup>8</sup>. It is the double ending both of the postwar boom and the Great Inflation of the 1970s and early 1980s that defines our present. Like it or not, we write the history of inflation after its end.

The narrative of the Great Moderation was gratifying, no doubt. But through their entanglement with history such narratives also put themselves at risk. They open themselves to revision and argument. Since 2007 the Western economies have been quaking under the impact of the second great shock to the fiat money order since the end of Bretton Woods. To fight the risk not of inflation but of deflation the central banks of the world have undertaken

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<sup>6</sup> For instance, Tony Killick, “Inflation in Developing Countries: an Interpretative Survey,” in: *Development Policy Review* 14 (1981), 1-17.

<sup>7</sup> Charles S. Maier, “The Collapse of Communism: Approaches for a Future History,” in: *History Workshop* 31 (1991), 34-59.

<sup>8</sup> Ben S. Bernanke, “The Great Moderation. Remarks by Governor Ben S. Bernanke at the meetings of the Eastern Economic Association,” Washington D.C., February 20, 2004; [www.federalreserve.gov/BOARDDOCS/SPEECHES/2004/20040220/default.htm](http://www.federalreserve.gov/BOARDDOCS/SPEECHES/2004/20040220/default.htm).

unprecedented emergency actions. We have escaped the nightmare of a return to the deflationary 1930s. But the complacency of the Great Moderation narrative has been broken beyond repair. The history of the 1970s inflation and disinflation was never as simple as it appeared in narratives designed to legitimate currency policy. In light of recent events we conclude that it is time to revisit the history of the Great Inflation – both the events of the epoch and the stories told about them – and to pose the question put to modernity by Alexander Kluge. Was the refoundation of democratic capitalism through the overcoming of inflation a learning process with a fatal outcome?<sup>9</sup>

## 2. Remapping Democratic Capitalism

Already as it happened, as prices and wages surged from the late 1960s onwards, inflation became the object for wide-ranging investigations by several cross-disciplinary collaborations between economists, political scientists, and historians. These ranged from the Trilateral Commission's notorious investigations of the crisis of democratic governance to Jürgen Habermas's mapping of a "legitimation crisis" at the Starnberg Institute<sup>10</sup>. One influential analysis came from a report on stagflation commissioned from the Organisation for Economic Co-operation and Development (OECD) in 1974 by Henry Kissinger. It was compiled under the leadership of Paul McCracken, chair of Nixon's Council of Economic Advisors and co-founder of the American Enterprise Institute.<sup>11</sup> Adopting a determinedly middle of the road position, refusing either strong Keynesianism or the new learning of rational expectations economics, when the McCracken report was published in 1977 it diagnosed inflation as the contingent result of "an unusual bunching of unfortunate disturbances unlikely to be repeated on the same scale, the impact of which was

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<sup>9</sup> Alexander Kluge, *Lernprozesse mit tödlichem Ausgang*, Frankfurt a.M. 1973.

<sup>10</sup> Michel J. Crozier/Samuel P. Huntington/Joji Watanuki, *The Crisis of Democracy: Report on the Governability of Democracies to the Trilateral Commission*, New York 1975; Jürgen Habermas, *Legitimationsprobleme im Spätkapitalismus*, Frankfurt a.M. 1973.

<sup>11</sup> *Toward Full Employment and Price Stability: A Report to OECD by a Group of Independent Experts*, Paris 1977. With Paul McCracken leading the team the authors included a cross-section of contemporary economic experts: Guido Carli, Hebert Giersch, Attila Karaosmanoglu, Ryutaro Komiya, Assar Lindbeck, Robert Marjolin and Robin Matthews. For some background on the McCracken Report, see Vincent Gayon, "The OECD experts and the 'crisis' of Keynesianism: the McCracken report (1975-1977)," European Social Science History Conference, April 2012, Glasgow; [https://plone2.unige.ch/OECDhistoryproject/intranet/doc/Gayon\\_2012\\_ESSHClides.pdf](https://plone2.unige.ch/OECDhistoryproject/intranet/doc/Gayon_2012_ESSHClides.pdf).

compounded by some avoidable errors in economic policy”<sup>12</sup>. Instead of offering more elaborate explanations, the McCracken report modestly focused on identifying the types of policy errors that could be avoided.

By 1977 those in search of anti-inflationary lessons could take inspiration from successful efforts at inflation-control in Germany, Switzerland and Japan. The *Bundesbank* in particular became exemplary. The mandate for price stability and the independence of the *Bundesbank* were principles enshrined in its founding act of 1948 and formalized in the *Bundesbank* law of 1957. But despite occasional clashes with the Adenauer government the full implications of the German monetary constitution were masked in the 1950s by the Bretton Woods system into which it was inserted<sup>13</sup>. Once full convertibility came into effect in 1958 the freedom of national central banks to pursue independent national monetary policy was tightly constrained. Between 1949 and 1973, given its mounting balance of trade surpluses, the Federal Republic’s inflation rate was higher than the Bretton Woods norm. Germany was repeatedly faced with the invidious choice between allowing even more rapid inflation and revaluing its currency. Inflation was unpopular, but an upward revaluation of the DM would, it was feared, jeopardize export competitiveness and thus employment. In the summer of 1972 Helmut Schmidt was still free to say in public that inflation was not the only priority. “It appears to me that – to put it succinctly – the German people can more easily tolerate 5 percent inflation than 5 percent unemployment.”<sup>14</sup> If one wished to avoid either revaluation or inflation the only alternative were capital controls, to prevent the influx of foreign funds. These were available as an option under the Bretton Woods system. But in Germany they had unpleasant associations with the age of Hjalmar Schacht and the Third Reich.

During the final crisis of Bretton Woods in 1971-1973, the inflationary pressure that defending the currency parities put on Germany was immense. On a single day, 1 March 1973, to prevent the DM rising against the weak dollar, the *Bundesbank* was forced to inflate the German

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<sup>12</sup> *Towards Full Employment*, 14. As quoted in Charles S. Maier, “Inflation and Stagnation as Politics and History,” in: Leon N. Lindberg/Charles S. Maier (Eds.), *The Politics of Inflation and Economic Stagnation*, Washington D.C. 1985, 3-24, here 5.

<sup>13</sup> Helge Berger, “The Bundesbank’s Path to Independence: Evidence from the 1950s,” in: *Public Choice* 93 (1997), 427-453.

<sup>14</sup> *Süddeutsche Zeitung*, 28. July 1972, 8: “Mir scheint, daß das deutsche Volk – zugespitzt – 5 Prozent Preisanstieg eher vertragen kann als 5 Prozent Arbeitslosigkeit.”

money supply by eight billion DM, 16 percent of the stock in circulation, the largest foreign exchange purchase ever made up to that point. A day later after a showdown with Willy Brandt's social-liberal government, the *Bundesbank* received permission to stop intervention<sup>15</sup>. This finally allowed Germany's central bankers to embark on their monetary *Sonderweg*. In December 1974, the *Bundesbank* introduced its new policy of anti-inflation monetary targeting with words that still echo down to our present: "there is no alternative"<sup>16</sup>.

With its emphasis on controlling the quantity of money, the Federal Republic, followed after 1975 by Japan, became the mecca for monetarists who preached Friedman's gospel that inflation "is always and everywhere a monetary phenomenon"<sup>17</sup>. If one screened out random shocks to prices, the central role for policy-makers must simply be to control the money supply. None of the other factors commonly invoked to explain inflation, oil price shocks for instance or trade union wage pressure, could by themselves cause an overall increase in prices. Tellingly, however, until the late 1970s the *Bundesbank's* turn to monetarism did not find general acceptance in either practical or in theoretical terms. At home the *Bundesbanker* had to undertake a campaign stretching from 1967 to 1981 to assert a new conservative, austere profile. It took at least a decade of ideological labor by the *Bundesbank* to make "DM Patriotismus" into a bipartisan property in the Federal Republic and to silence the sense of a choice offered by Schmidt's weighing up of five percent inflation against five percent unemployment. When they took their new doctrine abroad, the German inflation hawks faced even stiffer opposition. In the early 1970s even within the British Tory party, which was open to every neoconservative influence from across the Atlantic there was widespread skepticism about the narrow and highly technical, monetarist approach to inflation. As Norman Lamont, later to serve as John Major's ill-fated Chancellor, put it to an interviewer:

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<sup>15</sup> Harold James, *Making the European Monetary Union*, with a foreword by Mario Draghi, Cambridge (Mass.)/London 2012, 108; Report of the Deutsche Bundesbank for the Year 1973, 6; [www.bundesbank.de/Redaktion/EN/Downloads/Publications/Annual\\_Report/1973\\_annual\\_report.pdf](http://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Annual_Report/1973_annual_report.pdf). The foreign currency exchanges were also closed from March 2 to March 18, 1973.

<sup>16</sup> Report of the Deutsche Bundesbank for the Year 1974, 16; [www.bundesbank.de/Redaktion/EN/Downloads/Publications/Annual\\_Report/1974\\_annual\\_report.pdf](http://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Annual_Report/1974_annual_report.pdf).

<sup>17</sup> Milton Friedman, *Inflation: Causes and Consequences*, Bombay et.al. 1963, 17. For a critical evaluation of Japan see Takatoshi Ito, "Great Inflation and Central Bank Independence in Japan," in: Michael D. Bordo/Athanasios Orphanides (Eds.), *The Great Inflation. The Rebirth of Modern Central Banking*, Chicago 2013, 357-393, here 372.

“The big issue [within the Tory party in the early 1970s] was the means to control inflation and I think that is often underestimated today. There was a real belief in this country and in America, [...] that in order to control inflation you had to control the price of bread, you had to have price controls and wage controls and the idea that you could control inflation by interest rates and the money supply, to some people, just appeared unbelievable and I think that was the big early battle. [...] There were fierce arguments in the Conservative Party and among Members of Parliament and the then Prime Minister, Edward Heath, who refused to acknowledge that this was remotely relevant, the money supply. We were just told [...] you know, don’t be so simplistic.”<sup>18</sup>

As opposed to the one-dimensional formula of the monetarists, the 1970s produced an efflorescence of structuralist and historically-minded accounts of the political economy of inflation, along with policies to match. The young Charles Maier, fresh from his research into the political economy of the interwar period, was particularly active in giving historical depth to the inflation story. When, as the language of the McCracken report had it, “unfortunate disturbances” “bunched” to the degree that they had in the 1970s, Maier argued, broader “systemic” factors and “institutional structures” were at work<sup>19</sup>. After 1945, US hegemony, the structure of production, and abundant labor supplies had all contributed to enabling an exceptional period of rapid growth and monetary and financial stability. What the 1970s were witnessing was the exhaustion of those conditions and the breakdown of that order. Restoring stability, this implied, would require fundamental change both in the domestic and international political arena.

For many analysts, both from the left and the right, there had long been something eerie about the harmonious coexistence of capitalism and democracy since 1945 under the sign of the “postwar consensus”. No one in the 19th century had imagined that mass democracy and private property could be so easily reconciled. The interwar period had been wracked by class tension. The mounting distributional struggles from the late 1960s onwards were, therefore, a return to the norm. To many in the emergent school of public choice associated with James Buchanan, Richard Tullock, and Paul David, it seemed self-evident that inflation would arise in democracies caught up in a bidding war between egalitarian aspirations and self-serving politicians eager to

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<sup>18</sup> As quoted in Daniel Stedman Jones, *Masters of the Universe: Hayek, Friedman, and the Birth of Neoliberal Politics*, Princeton/NJ 2012, 237.

<sup>19</sup> Maier, *Inflation and Stagnation*, 5. Though published only in 1985, most of the volume’s chapters originate as contributions to a 1978 Brookings conference on inflation.

please and appease them<sup>20</sup>. But this understanding of the link between democracy and inflation was not restricted to the right. John Goldthorpe, in his classic sociological analysis from 1978, argued that inflation had to be understood “as the monetary expression of distributional conflict, [...] ultimately grounded not in error, ignorance or unreason [...] but rather in on-going changes in social structures and processes”<sup>21</sup>. It was the development of democratic market society that brought these social conflicts and changes to the fore. Increasingly open distributional struggle was a sign of social maturity.

What was at stake in the debates between left and right structuralists were attitudes towards the “mixed economies” of the postwar period. For the right, the 1970s marked the point at which the slippery slope had taken on a dangerous incline. As Buchanan and Wagner put it, inflation was associated with a “generalized erosion in public and private manners, increasingly liberalized attitudes toward sexual activities, a declining vitality of the Puritan work ethic, deterioration in product quality, explosion of the welfare rolls, widespread corruption”<sup>22</sup>. In persistent inflation they saw the specter of “Latin Americanization”<sup>23</sup>. To stave off this disastrous fate what was required was deep structural reform. Quite how thoroughgoing this reform would have to be was dramatized by the so-called Rational Expectations school of economics and the time-inconsistency literature that issued from it. In a hugely influential 1976 essay Lucas showed that standard models for developing optimal policy were undone by the reflexivity of modern society<sup>24</sup>. Once it was assumed that policy was effective in manipulating the economy, rational

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<sup>20</sup> See for example, James M. Buchanan/Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes*, New York 1977; William D. Nordhaus, “The Political Business Cycle,” in: *Review of Economic Studies* 42 (1975) H. 2, 169-190; C. Duncan MacRae, “A Political Model of the Business Cycle,” in: *Journal of Political Economy* 85 (1977) H. 2, 239-263; Assar Lindbeck, “Stabilization Policy in Open Economies with Endogenous Politicians,” in: *American Economic Review* 66 (1976) H. 2, 1-19; Brian Barry, “Does Democracy Cause Inflation? Political Ideas of Some Economists,” in: Maier/Lindberg (Eds.), *Politics of Inflation*, 280-317, provides an extensive survey.

<sup>21</sup> John H. Goldthorpe, “The Current Inflation: Towards a Sociological Account,” in: Fred Hirsch/John H. Goldthorpe (Eds.), *The Political Economy of Inflation*, Cambridge (Mass.)/London, 1978, 186-213, here 195.

<sup>22</sup> James M. Buchanan/Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes*, New York 1977, 64-65. As quoted in Brian Barry, *Does Democracy Cause Inflation?*, 284.

<sup>23</sup> Peter A. Johnson, *The Government of Money. Monetarism in Germany and the United States*, Ithaca/New York 1998, 165.

<sup>24</sup> Robert E. Lucas, “Econometric Policy Evaluation: A Critique,” in: *Carnegie-Rochester Conference Series on Public Policy* 1 (1976) H. 1, 19-46. Robert E. Lucas/Thomas J. Sargent, “After Keynesian Macroeconomics,” in: *Federal Reserve Bank of Minneapolis Quarterly Review* 3 (1979) H. 2, 1-16.

economic actors would have to be modeled as anticipating and reacting to policy, a feedback loop that destabilized the structural models on which policy was supposed to be based. Unless a rigid policy rule was adopted, the outcome was unpredictable. A year later Kydland and Prescott went on to drive home the case for a rule-bound policy but also brought out the tragic paradox this involved<sup>25</sup>. Having adopted a specific rule and encouraged society to believe in it, policy-makers would face a gigantic temptation to exploit that fact and to engage in rule-breaking discretionary policy. The results, though the policy-maker might achieve short-term improvements, would be suboptimal in the long run. The only way to minimize this problem of time inconsistency and to avoid “excessive inflation” was for stringent monetary and fiscal rules to remove policy entirely from the political process, placing it in the hands of independent central bankers, who were committed as publicly as possible to the most stringent targets<sup>26</sup>. In 1977 that seemed like whistling in the dark.

### 3. Governing at a Distance

With hindsight what is most striking about contemporary analyses of inflation dating to the 1970s, whether they be accidentalist à la OECD, left-structuralist or right-structuralist, is their failure to anticipate the scale of the transformation that lay ahead. We tend to forget how miraculous our current situation of democracies across the developed world, binding themselves to policies of low inflation and fiscal austerity would have appeared to most observers in the 1970s. Writing in the mid 1970s Goldthorpe was convinced that the right-wing anti-inflation hawks were doomed to disappointment. No “responsible” politician would risk anti-inflationary policies that put the “legitimacy of government” at stake in “head-on and powerful” confrontations with major interest groups, he opined<sup>27</sup>. But they did. And what is more the structuralists were not wrong. Inflation *was* driven by powerful social forces and the repression of inflation coincided

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<sup>25</sup> Finn E. Kydland/Edward C. Prescott, “Rules Rather than Discretion: The Inconsistency of Optimal Plans,” in: *The Journal of Political Economy* 85 (1977) H. 3, 473-492. In 2004, the two received the Nobel Memorial Prize in Economics for their contributions to the time consistency of economic policy.

<sup>26</sup> Ibidem, 487.

<sup>27</sup> Goldthorpe, *Current Inflation*, 210.



with a surge of unemployment to levels not seen since the 1930s and some of the most violent industrial struggles that democratic capitalism was to witness in the second half of the 20th century.

How then do we explain the turn against inflation? In the most popular narratives of the Great Inflation what fills this explanatory gap are various types of *deus ex machina*, most notably the idea of heroic anti-inflationary political leadership<sup>28</sup>. This is the final element of the conventional narrative of inflation and disinflation in the 1970s and 1980s. If inflation was a symptom of political weakness and disunity – a symptom of the inability of Western societies to face sudden shifts in the international terms of trade – then what was required to end it was unifying and authoritative leadership. Enter from stage right, Ronald Reagan and Margaret Thatcher, bringing with them the gospel of monetarism, embodied in the US case by Paul Volcker. Heroic leadership equipped with the right ideas would break the conventional boundaries of 1970s interest group politics. No one more dramatically and self-consciously personified the politics of anti-inflationary rigor than Thatcher. And once again there is a mirroring of this heroic conservative narrative from the left. For the left, Thatcher became a figure of horrified fascination<sup>29</sup>. The animosity she drew to herself could still be felt thirty years later in the unfeigned rejoicing that accompanied her funeral in April 2013<sup>30</sup>. In his widely read “Buying Time” Wolfgang Streeck restates this familiar narrative common to both the left and the right. Following Goldthorpe, Streeck postulated that the 1970s inflation served as a means of deferring fundamental distributional conflicts within democratic capitalism, “buying time” by means of conjuring monetary illusions and then concludes that

“the monetary stabilization of the world economy in the early 1980s was a *tour de force* that came with a high political risk; it could be undertaken only by governments, such as those of Reagan and Thatcher, that were willing to trade mass unemployment for the

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<sup>28</sup> Daniel Yergin/Joseph Stanislaw, *The Commanding Heights: The Battle Between Government and the Marketplace that is Remaking the Modern World*, New York 1998; William L. Silber, *Volcker: The Triumph of Persistence*, New York 2012.

<sup>29</sup> Stuart Hall set the tone with: “The Great Moving Right Show,” in: *Marxism Today* 1978, reprinted in Stuart Hall, *The Hard Road To Renewal: Thatcherism and the Crisis of the Left*, London 1988, 39-56.

<sup>30</sup> The Guardian, April 8, 2013: “Margaret Thatcher’s death greeted with street parties in Brixton and Glasgow”.

restoration of ‘sound money’ and to crush the expected social resistance at whatever cost.”<sup>31</sup>

Of course, there is no denying that the refounding of the constitution of capitalist democracy in Britain and America in the early 1980s, involved both savage shocks to the labor market and strike-breaking action by the state. But was this in any sense necessary as both Streeck and neoconservative heroic narratives would have us believe? Is the dramatic scenario of a high-risk stabilization effort led by the neoconservative will of Reagan and Thatcher really plausible as a historical interpretation? Much contemporary evidence, as well as thirty years of subsequent research suggests not.

The class-conflict model suggests that inflation was a populist path of least resistance. But opinion poll evidence from across the developed world in the 1970s challenges this familiar picture of escapist inflationary politics. Far from viewing inflation as a lesser evil, the popular imagination was ruled from the early 1970s by a concern for inflation bordering on fear. Germany was the most extreme case. Though monthly inflation peaked in West Germany in late 1973 at not even eight percent, a full 89 percent of Germans reported in 1974 to be “very worried or frequently worried” by inflation<sup>32</sup>. But this was not only a German obsession. In the US too, inflation ranked number one as the most important problem facing the country for eight consecutive years from 1973 to 1981<sup>33</sup>. Writing in 1979, Daniel Yankelovich, the well-known analyst of American public opinion, could comment that “for the public today, inflation has the kind of dominance that no other issue has had since World War II”<sup>34</sup>. Ahead of the 1979 British General Election that would elevate Thatcher into office, 59 percent of voters thought inflation to be the single most important issue facing Britain. Strikes and unemployment came second and

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<sup>31</sup> Wolfgang Streeck, *Buying Time: The Delayed Crisis of Democratic Capitalism*, London 2014, 34.

<sup>32</sup> Allensbach Institut, April 1974. As cited in: *Der Spiegel*, April 15, 1974: “Umfrage: Angst und Sorge wählen CDU/CSU”. 73 percent worried about the effects of inflation on their savings.

<sup>33</sup> In 1982 and 1983, inflation was only beaten by high unemployment. See Robert J. Samuelson, *The Great Inflation and its Aftermath*, New York 2010, 23.

<sup>34</sup> Daniel Yankelovich, “The Noneconomic Side of Inflation,” in: Clarence C. Walton (Ed.), *Inflation and National Survival*, New York 1979, 20. As quoted in Samuelson, *The Great Inflation and its Aftermath*, 20.

third with 32 and 28 percent respectively<sup>35</sup>. The inflation hawks of the 1970s may have styled themselves as countercultural but they were in fact moving with a broad current of opinion.

National historical narratives may have played a role in some cases in stoking anti-inflation attitudes, notably in Germany where the *Bundesbank* deliberately revived popular memories of 1923<sup>36</sup>. Concern for inflation may really have been a screen for deeper anxieties about the kind of social tensions that lay behind price increases. The fact that strikes ranked second in the British opinion poll data should be no surprise. There can be little question either that public anxiety was fed in a circular process by the rhetoric of political leaders. As exemplified by Reagan and Thatcher, political leadership came to be redefined and radicalized in terms of anti-inflation politics. But the invocation of the contingent factor of personality and leadership belie the fact that for most of modern history, advanced capitalist societies have found ways to resist inflation. As DeLong points out, in the United States for a politician to openly advocate inflation has for more than a century been the kiss of electoral death<sup>37</sup>.

What the class conflict approach to inflation à la Goldthorpe all too easily underestimates is the material interest of powerful social groups in systemic stability<sup>38</sup>. Particularly in the mixed economy built up since the 1930s, institutions and regulatory systems accumulated that were profoundly challenged by a substantial and unexpected increase in inflation. The interests involved were heterogeneous but they easily coalesced around the popular anti-inflation theme, cutting across class lines. In the German case the official trade union leadership was every bit as interested as employers in seeing an end to inflation. They were deeply disturbed by the undisciplined wave of wildcat strikes that erupted in 1969 as inflation accelerated during a period of corporatist wage restraint. For those committed to corporatist bargaining the fewer destabilizing shocks the better. Likewise, the complex of savings institutions, pension funds and mortgage finance created in many industrialized societies since the 1930s relied on assumptions about inter-

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<sup>35</sup> Ipsos Moris 1979 Pre-Election Poll from 29 March 1979; [www.ipsos-mori.com/researchpublications/researcharchive/poll.aspx?oItemId=2583](http://www.ipsos-mori.com/researchpublications/researcharchive/poll.aspx?oItemId=2583).

<sup>36</sup> Johnson, *Government of Money*, 199.

<sup>37</sup> James Bradford DeLong, "America's Historical Experience with Low Inflation," in: *Journal of Money, Credit and Banking* 32 (2000), 979-993.

<sup>38</sup> Kenneth Scheve, "Public demand for low inflation," London 2002 (Bank of England Working Paper, no. 172), summarizing the literature on the demand for low inflation.

est rates that could not be sustained as inflation accelerated. By the 1970s in the US nothing less than the functioning of the entire housing market was at stake. Likewise, inflation impacted the vast majority of the population through taxes. In the wake of World War II the tax state had become an intrusive presence in the budgets of all but the poorest households. The effect of inflation was to drive painful “bracket creep”<sup>39</sup>. Meanwhile, less well-off households on benefits had to fear that their payments would not be adjusted<sup>40</sup>.

In theory one could imagine a perfectly indexed social and economic system that would be indifferent to inflation. In practice there was very good reason for tens of millions across the developed world to prefer a world in which prices were stable. The networks of dependence and obligation that underpinned the stability coalition were subtle and can appear slight in relation to the massive social forces – capital, labour, etc. – invoked by simpler class-based analysis. Money is a social medium. Like other media, such as language, law, perhaps even politics itself, it defies explanation in crude interest group terms. But this does not mean that it is inconsequential or that we have no interest in it. The disruptions to the monetary system unleashed by the Great Inflation of the 1970s had all pervasive effects and provided the raw material out of which a variety of election-winning anti-inflation coalitions could be and were built.

Contrary to what would be predicted by both left- and right-structuralists, there is little evidence that policy-makers in the 1970s ever took the inflation problem anything other than extremely seriously. Evidence of inflationary escapism or “money illusion” is far less common than one would expect. Given the wall of public hostility to inflation, to prioritize stimulus over price stability as was attempted by several countries in the early 1970s was itself a high-risk political strategy. It could be justified not in terms of a short-term boost to employment, but only as part of a “dash for growth”, a deliberately unbalanced strategy aiming to restore the vitality of national economic development<sup>41</sup>. As to the existence of a robust trade off between inflation and

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<sup>39</sup> Martin S. Feldstein, “The Costs and Benefits of Going from Low Inflation to Price Stability,” in: *Reducing Inflation: Motivation and Strategy*, Chicago 1997, 123-166, on fiscal drag.

<sup>40</sup> Robert J. Shiller, “Why Do People Dislike Inflation?,” in: Christina D. Romer/David H. Romer (Eds.), *Reducing Inflation: Motivation and Strategy*, Chicago 1997, 13-70.

<sup>41</sup> On British policy choices in this period see, Martin Daunton, “Presidential Address: Britain and Globalisation since 1850, IV: the Creation of the Washington Consensus,” in: *Transactions of the Royal Historical Society* VI-19 (2009), 1-35.

unemployment – the relationship known as the Phillips curve – there is precious little evidence that anyone believed in it by the 1970s<sup>42</sup>. If there ever was a moment of confident belief in the long-run Phillips curve trade-off it was the 1960s not the 1970s. The dominant inflation models of the 1970s were neither the Phillips curve nor monetarism, but complicated structuralist, cost-push theories, proffered in particular by the left-wing of Keynesianism. The end of Bretton Wood energized not just the monetarists, but the left wing of the economic policy debate as well. Keynesianism did not simply fade away in the face of the monetarist onslaught. Keynesianism internationalized, spawning efforts at global economic modeling such as Lawrence Klein’s LINK model and the “locomotive theory” of international stimulus championed by the Carter administration<sup>43</sup>. Meanwhile at the national level, left-Keynesianism sought to radicalize the rather anemic consensus Keynesianism of the 1950s and 1960s by calling for intrusive growth-oriented industrial policies, national protection and corporatist grand bargains with organized labor<sup>44</sup>. This did not mean dismissing inflation as a policy priority. Rather it raised the stakes in inflation control. If inflation was the monetary expression of distributional conflict, so the argument went, that conflict would have to be made explicit and bargained over at the conference table. What this implied was an open politicization of the economy.

As Greta Krippner has pointed out in her path-breaking study of financialization in the US, the effect of the 1970s inflation was not to relieve politics of critical decisions, but to accelerate the pace and breadth of politicization of prices, wages, fees, taxes and interest rates, all of which had to be inflation-adjusted<sup>45</sup>. If there was a legitimation crisis in the 1970s, then inflation, rather than serving as a safety valve, or a politically cheap means of “buying time”, almost immediately began to be viewed as both a symptom and an exacerbating cause of delegitimization. As recent intellectual histories of the new right have shown, the main attraction

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<sup>42</sup> Christina D. Romer, “Commentary,” in: *Review Federal Reserve Bank of St Louis* 87 (2005), 177-185; Edward Nelson, “The Great Inflation of the Seventies: What really happened?,” in: *Advances in Macroeconomics* 5 (2005), 1-48.

<sup>43</sup> Lawrence R. Klein, “Project LINK: Linking national economic models,” in: *Challenge* 19 (1976) H. 1, 25-29.

<sup>44</sup> Anthony Seldon/Kevin Hickson (Eds.), *New Labour, Old Labour: The Blair, Wilson and Callaghan Governments 1974-1979*, London 2004; John Callaghan, “Rise and Fall of the Alternative Economic Strategy: From Internationalisation of Capital to ‘Globalisation’,” in: *Contemporary British History* 14 (2000) H. 3, 105-130.

<sup>45</sup> Greta Krippner, *Capitalizing on Crisis. The Political Origins of the Rise of Finance*, Cambridge/Mass. 2011, 107.

of the monetarist agenda was not that it promised a more direct and aggressive assault on inflation<sup>46</sup>. Wage and price controls could hardly be bettered in terms of directness. By contrast, monetarism was widely regarded even by many conservatives as a risky, hands off alternative. Because they attacked the problem only indirectly by way of the money supply, the monetarists were dubbed the “chiropractors of modern economics”<sup>47</sup>. The real charm of monetarist anti-inflation politics was precisely that by “governing at a distance” they promised a means of depoliticizing the economy and of restoring the economy as a “neutral” non-political realm, relieving the enormous burden of legitimization that the more interventionist policies of the 1970s had imposed on the political system<sup>48</sup>.

With regard to the familiar heroic narrative of disinflation, the effect of this triple revision – stressing the importance of anti-inflationary social interests, the bipartisan commitment to anti-inflation policies and the central imperative of depoliticization – is significant. The standard narratives figures counter-inflationary politics as heroic deed driven by technocratic insight pitched against the structural forces of mass democracy and interest group politics. For a conservative central banker such as the German Otmar Issing, for instance, the challenge was one of eternal vigilance: “We ought to have learned from history that the value of money remains in peril everywhere and at all times.”<sup>49</sup> But what this ignores is that in most places most of the time, there were also significant countervailing forces acting against inflation. The hawkish central bankers rarely if ever stood alone. Nor should it be taken for granted, to address the counterfactual normally implied, that without the election of Margaret Thatcher or Ronald Reagan, Britain and the US would have spent the 1980s galloping towards accelerating inflation. Given the very real force of counter-inflation interests in society, the fact that anti-inflation politics came to fore is not by itself surprising. If it was undeniably true that Reagan and Thatcher accepted rising unemployment as the price of combating inflation, it is hardly the case that this involved them in hair-raising political risks. As mentioned above, the opinion poll evidence from the time suggests the opposite. Given the pronounced strength of the anti-inflation majority and

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<sup>46</sup> Stedman Jones, *Masters of the Universe*.

<sup>47</sup> William Greider, *Secrets of the Temple: How the Federal Reserve Runs the Country*, New York 1989, 93.

<sup>48</sup> Summarizing the literature, Nikolas Rose/Peter Miller, “Political Power beyond the State: Problematics of Government,” in: *The British Journal of Sociology* 61 Issue Supplement s1 (2010), 271-303.

the strength of the anti-union affect, to prioritize employment and to have remained in dialogue with important social interest groups over the collective management of the macroeconomy, would have been the far bolder political choice. Populisms come in many forms. The populism of Reagan and Thatcher was of the anti-inflation, anti-welfare, anti-union variety.

The aim of our anti-heroic narrative of disinflation is not, however, simply to suggest a revision of familiar view of the Thatcher and Reagan “revolutions”. The aim is to revise our understanding of the problem of democracy in relation to economic policy. Left- and right-structuralists postulate a conflict between democracy and capitalism, which, on the left reading, must either lead to terminal crisis, or in the right-structuralist version must be overcome by depoliticization. That is the moral drawn from the history of inflation in the 1970s and the 1980s. Inflation was a political and economic time bomb that had to be defused as urgently as possible. A critique of both positions by way of a new history of the struggle over inflation in 1970s, would, by contrast, seek to disarm this rhetoric of emergency and necessity. What we must insist upon is that under conditions of a fiat money regime, the choice of deflation or inflation is open. The problem is not that of a lethal and urgent menace to the common good. It is that of a political choice with distributional consequences. The historical question is how that openness became foreclosed and how the history of that closure has been told. Depicting the history of the 1970s as a choice between a populist and delusionary “sell out” to inflation, and the virtue and realism of disinflation, is the beginning of that closure.

#### **4. The Politics of Disinflation**

Once we remove the blinders of the conventional narrative of the “conquest of inflation”, what is remarkable is how complex, historically contingent and politically multivalent the emerging anti-inflation coalitions of the 1970s were. Even in Germany, so often cited as the prime example of steadfast anti-inflation politics, the course was far from predetermined. Between 1967, when serious inflationary pressure began to build up within the Bretton Woods systems, and 1974, the *Bundesbank* was rocked by what one participant referred to as a “war of

religion”<sup>50</sup>. Karl Klasen, the social democratic President of the Bank, backed by Helmut Schmidt, the rising star in the SPD/FDP coalition, favored “Schachtian” exchange controls and regulation to contain the inflationary pressure whilst avoiding revaluation. They were opposed by a coalition of pragmatic Keynesians such as Karl Schiller and out-right monetarists who were united on the need to break up Bretton Woods and float the DM. It was the monetarists who prevailed by 1974 but they did so in the form of what Johnson calls a “monetarist corporatism”, in which monetary targets were used not to break the labor movement, but to signal the need for restraint in wage setting<sup>51</sup>. There was even talk of appointing a trade unionist to the *Bundesbank* board, which was in any case full of Social Democrats.

It was this German model of social market monetarism that attracted Valéry Giscard D’Estaing and his new centrist technocratic Prime Minister Raymond Barre, when they undertook the first serious disinflationary effort in France in August 1976. Combatting inflation was Barre’s top priority. Introducing the program of his government of the French National Assembly Barre referred to the inflation menace no less than 20 times<sup>52</sup>. Though the Barre Plan involved monetarist monetary targeting, it mobilized the entire apparatus of French planification. The exchange rate peg to the DM was reinforced so as to force French industry into streamlining and pressure the trade unions into wage restraint. Meanwhile, the government publicly announced a money supply target and sought to manipulate the allocation of credit within the framework known as the *encadrement du crédit*. The aim was disinflation, the analytic framework was monetarist, but the means employed were extensively interventionist, providing different credit targets and interest rates for the public sector, for domestic industrial investment and more speculative commercial and financial transactions<sup>53</sup>.

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<sup>50</sup> This episode is captured in Johnson, *Government of Money*, ch. 3, here 70.

<sup>51</sup> Johnson, *Government of Money*, 109.

<sup>52</sup> Emmanuel Mourlon-Druol, *A Europe Made of Money: The Emergence of the European Monetary System*, Ithaca 2012, 106.

<sup>53</sup> Michael Maurice Loriaux, *France after Hegemony. International Change and Financial Reform*, Ithaca 1991, 38-43.



The politics of disinflation were even more polyvalent in Italy in the 1970s<sup>54</sup>. In 1974 the Socialists reluctantly backed an austerity package negotiated by the Christian Democrats with the International Monetary Fund (IMF), which they then abandoned within a year in a blatant effort to manipulate the business cycle ahead of parliamentary elections. The result by January 1976 was a manifest currency crisis. Though both the United States and West Germany made clear that they would cut off all financial aid to Rome if the Communists entered government, the *Partito Comunista Italiano* (PCI) in fact gave the Christian Democrats their full support in negotiating a new IMF rescue package. Rather than pursuing an aggressive strategy of wage-bargaining the PCI sought a new profile as a responsible partner in power, appealing to the anti-inflation sentiment amongst centrist voters. Crucially, the PCI intervened with the major trade union, the *Confederazione Generale Italiana del Lavoro*, to persuade it to relax wage indexation rules clearing the path to an Italian agreement with the IMF in April 1977. By 1979 the Italian Communists were hoping that their willingness to back an austerity program against the short-term interests of the trade union constituency would be rewarded by their inclusion for the first time in a coalition government.

It was in the US and above all in Britain that the politics of money escalated in a truly confrontational manner. But even there, this was not a foregone conclusion. In the 1970s the politics of counter-inflation was still a bipartisan issue. Already in 1974, during the first bout of inflation, President Gerald Ford had compared inflation to a “well-armed wartime enemy,” famously dubbing inflation “our public enemy number one”<sup>55</sup>. In 1976 a Labour government in Britain steeled itself to accept an IMF program and publicly renounced any naïve faith in Keynesianism. At the same time it spent precious political capital in seeking a deal with its trade union allies to limit wage increases. On 24 October 1978, President Jimmy Carter in a nationally televised address reiterated both the stance of his predecessor and the resounding message from the public opinion polls: inflation was America’s number one domestic problem. Given the weakness of the dollar on the international exchanges, with the monetarist-inspired Shadow Open

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<sup>54</sup> John B. Goodman, *Monetary Sovereignty. The Politics of Central Banking in Western Europe*, Ithaca 1992, 149-164.

<sup>55</sup> Gerald R. Ford, “Address to a Joint Session of the Congress on the Economy, October 8, 1974,” in: *Public Papers of the Presidents of the United States. Administration of Gerald R. Ford* (GPO 1975), 228-238.

Market Committee warning of the “Latin Americanization”, President Carter’s invoked one of the most heroic moments of English-speaking democracy<sup>56</sup>:

“Nearly 40 years ago, when the world watched to see whether his nation would survive, Winston Churchill defied those who thought Britain would fall to the Nazi threat. Churchill replied by asking his countrymen, ‘What kind of people do they think we are?’ There are those today who say that a free economy cannot cope with inflation and that we’ve lost our ability to act as a nation rather than as a collection of special interests. And I reply, ‘What kind of people do they think we are?’ I believe that our people, our economic system, and our government are equal to this task. I hope that you will prove me right.”<sup>57</sup>

This was not democracy speaking the language of appeasement, “buying time”, or indulging in inflationary escapism. This was the language of Dunkirk and of “blood, toil, tears and sweat”. For better or worse, it was Carter, not Reagan, who appointed the hawkish Paul Volcker to chair the Fed. It was a significant choice precisely because Volcker’s priorities were known to be the stabilization of the international monetary system anchored on the dollar, and not domestic unemployment<sup>58</sup>. On the fiscal front in 1980 Carter ended any chances of reelection with an austere budget hailed by the “Financial Times” as an act of “sheer political courage”<sup>59</sup>.

## 5. The Turn

It was between 1979 and 1986 that the politics of inflation and anti-inflation took on the resolutely conservative, free-market, anti-labour character that would later be naturalized in the heroic narrative of Thatcher and Reagan. This cannot be understood except in an international context. In the great disinflation of the early 1980s international power and influence were crucial factors. The politics of money was directly linked to the rallying of “the West” in the final confrontation of the Cold War.

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<sup>56</sup> Johnson, *Government of Money*, 163.

<sup>57</sup> Jimmy Carter, “Anti-Inflation Program. Address to the Nation, October 24, 1978,” in: *Public Papers of the Presidents of the United States. Administration of Jimmy Carter* (GPO 1979), 1844.

<sup>58</sup> Stein, *Pivotal Decade*, 227.

<sup>59</sup> As reported by the New York Times News Service, in the US press, see Wilmington Star-News, Sunday, March 16, 1980, 14-A.

The financial markets were the first medium through which international pressures became apparent. By 1976 Italy, France and Britain were all feeling the pressure. In 1978 the dollar itself came under sustained attack. In 1980-1981 it was the turn of the *Deutschmark*. The reaction both in the US and Britain was to initiate shock therapy that gave a new and far more unambiguous political complexion to disinflation. The interest rate-hike, both in Britain and the US, was savage and taken without regard for unemployment. Casting aside any possibility of corporatist coordination, which had been a key element in Germany's successful efforts at inflation control in the early 1970s, Reagan and Thatcher adopted an aggressively anti-union stance. Thatcher's anti-union campaign culminated in the epic struggle to defeat the mineworkers union in 1984-1985. Paul Volcker was only articulating what was an open secret when he commented that, "the most important single action of the (Reagan) administration in helping the anti-inflation fight was defeating the air traffic controllers' strike" in August 1981<sup>60</sup>. And this domestic campaign was explicitly linked to an aggressive reassertion of the frontlines in the global Cold War. In Europe it was Helmut Schmidt who responded most vigorously to the perceived crises of American leadership. In strategic terms he took the initiative in launching the rearmament proposals that would convulse the NATO countries until the early 1980s. In economic terms he pushed a new project of European monetary integration, the European Monetary System (EMS)<sup>61</sup>.

There was of course an evident economic rationale for the EMS from the German point of view. The currency system would slow the depreciation of the European currencies against the DM. But there was far more at stake for Schmidt than a mercantilist exercise in export promotion. This became evident in 1978 when the EMS proposal was put to the *Bundesbank*. For the *Bundesbankers*, the EMS was a mixed blessing. It implied a considerable constraint on the autonomy they had struggled to establish since the end of Bretton Woods. Any fixed exchange rate regime would limit their ability to set national monetary policy. And a currency pact with the French and the Italians, in which Germany was not guaranteed the deciding voice, could easily

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<sup>60</sup> Paul Volcker, in Martin Feldstein (Ed.), *American Economic Policy in the 1980s*, Chicago/London 1994, 162.

<sup>61</sup> James, *Making the European Monetary Union*, 146-150. For a history of Schmidt's related focus on the world economic summits, see Johannes von Karczewski, "*Weltwirtschaft ist unser Schicksal*": *Helmut Schmidt und die Schaffung der Weltwirtschaftsgipfel*, Bonn 2008.

become an inflationary club. It was against such doubts that Chancellor Helmut Schmidt used the crucial meeting of the governing board of the *Bundesbank* on 30 November 1978 to first formulate the bludgeoning combination of arguments that ever since have dominated German policy towards the European project. Self-consciously transgressing beyond the realm of economics, Schmidt insisted that there was no alternative to European monetary integration because it was the financial counterpart to Germany's Western integration, its membership in NATO and the legacy of Auschwitz<sup>62</sup>. Germany must lead the way. One cannot oppose such arguments directly in the Federal Republic. But the *Bundesbanker* exacted a price. In a note to Otmar Emminger, Schmidt promised that the EMS would not be coupled to the kind of inflationary support that had become a feature of Bretton Woods in its last days. The *Bundesbank* would not be required to print billions of DM to prop up the French Franc or the Lira, as it once had done for the dollar.

With this confidential promise by the social-liberal government to the *Bundesbank*, the basic structure of the European monetary project was set. Germany was irreversibly bound in, but the burden of adjustment would be placed one-sidedly on the weaker currencies in the system. European monetary integration would be a disinflation project. Schmidt, however, was anything but a simple-minded advocate of austerity. Despite ballooning public deficits, when the second oil crisis struck and growth in Europe slumped, Schmidt's reaction was to cobble together an international stimulus package. In conjunction with his ally the French President Giscard D'Estaing, Schmidt entered into conversations with Saudi Arabia with a view to recycling Arab oil money into investment in Europe. As in the US in the early 1980s, monetary tightening might have been softened by fiscal expansion. But three factors thwarted Schmidt's plan to enact a Rhenish version of Reaganomics: the radicalism of the Fed's shock therapy, French voters, and the *Bundesbank*. All three strands – the American and British turn to disinflation, the power struggle between the Schmidt government and the *Bundesbank*, and the rise and fall of the Mitterrand experiment between 1980 and 1983 – are familiar episodes. But it was their intertwining that tied the Gordian knot of European deflation.

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<sup>62</sup> James, *Making the European Monetary Union*, 176.

When the dollar began its upward movement in October 1979, its pressure on the relative exchange rates among the European currencies could be felt immediately. Between October 1980 and March 1981 the DM lost 15 percent of its value despite Frankfurt drawing extensively on the resources of the common European monetary fund. With oil prices reaching new heights, the disinflationary block in Europe seemed to be losing its grip. Even Switzerland, Germany's partner in disinflation in the 1970s, saw its inflation rate peak at eight percent in 1981. On 19 February 1981, the *Bundesbank* ran out of patience. To halt the slide, the *Bundesbank* jacked up interest rates from nine to 12 percent. Overnight borrowers at the Lombard window faced rates of 28 percent. In a less than subtle move, the *Bundesbank* intervened in wage negotiations, pressuring the influential *IG Metall* trade union to accept wage restraint. Chancellor Schmidt found himself in an embarrassing situation, made even worse by sniping from the left-wing of the SPD and increasing doubts within the FDP about its role in the coalition. By May 1981 Schmidt's effort to stem the austerian tide had collapsed and a path of consolidation had won the day in Bonn.

Against this disinflationary tide, French voters were called to the polls on 13 April. In the second round on 11 May 1981 they opted to embark on the most radical political experiment since 1936: an updated *Front populaire* of a socialist government with communist participation and an open agenda of economic nationalism. 12 major corporations and 39 banks and financial institutions would be nationalized. The minimum wage was raised by 10 percent, the minimum pension by 20 percent. 150,000 public servants were added to the pay-roll. On the day of Mitterrand's election a run on the Franc began that would consume \$ three billion in reserves in a matter of days. On 22 May, France introduced capital controls. Suddenly, Germany found itself back in the driver's seat of the EMS. Karl Otto Pöhl, president of the *Bundesbank*, did not conceal his opinion that a France under a Popular Front government was out of place in the European Monetary System<sup>63</sup>. On 5 October 1981, France underwent an embarrassing currency readjustment and the *Banque de France* reacted, just as the *Bundesbank* had done at the beginning of the year, by refusing short-term loans to the government. The World Economic Summit hosted by the Mitterrand government in June 1982 in Versailles descended into embarrassing disaster. With the Franc on the skids, French Prime Minister Mauroy was reduced

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<sup>63</sup> David Marsh, *Europe's Deadlock. How the Euro Crisis Could Be Solved – and Why It Won't Happen*, New Haven/London 2013, 76.

to chasing Mitterrand down the corridors of the Versailles palace crying out: “I can’t hold it, I can’t hold it.”<sup>64</sup> The next round of devaluation came on 12 June. As France’s position with the EMS became increasingly untenable, the famous reversal of French politics came in the third week of March 1983 as the more international, pro-European, pro-American group around Jacques Delors emerged victorious and issued a commitment to the *franc fort*. For the hawks in Paris, allegiance to the hard EMS position established by the *Bundesbank* at the moment of Mitterrand’s election would henceforth serve as a “break” on any French “divergence”.

The period spanning the advent of the Volcker regime at the Fed, the capitulation of the Mitterrand government in the spring of 1983 and the Thatcher government’s deregulation of the City of London in October 1986, marked a transition of world historical significance. Under Bretton Woods, limits on capital mobility had protected the fixed exchange rate system. Now, for the first time sovereign money, decoupled from gold, came to be combined with a radical opening of capital markets anchored on Wall Street, London, Frankfurt and Paris. Rawi Abdelal has shown the significance of the reversal in the French position that facilitated this change<sup>65</sup>. Starting in late 1983 the French capital accounts were gradually opened in a radical deviation not just from Mitterrand’s previous position but that of all postwar governments before him. By June 1988 a European Council directive would oblige all member states to liberalize all capital movements<sup>66</sup>. The decontrol of the capital account went hand in hand with attempts to bring down inflation by tying France to the EMS and thereby indirectly to the monetary policy of the *Bundesbank*. For the likes of Delors the *tournant* of 1983 implied first and foremost that “our struggle against inflation was reinforced”<sup>67</sup>. But the turn to monetary conservatism led by the *Bundesbank* was Europe-wide. Between 1981 and 1983, not just the French but the Dutch, the Belgians, the Danes and the Austrians all abandoned any prospect of ambitious social democratic politics<sup>68</sup>.

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<sup>64</sup> James, *Making the European Monetary Union*, 194.

<sup>65</sup> Rawi Abdelal, *Capital Rules: The Construction of Global Finance*, Cambridge/Mass. 2009, 54-85; see also Mark Mazower, *Governing the World. The History of an Idea, 1815 to the Present*, New York 2012, 409-410.

<sup>66</sup> Directive 88/361/EEC; Abdelal, *Capital Rules*, 57.

<sup>67</sup> Abdelal, *Capital Rules*, 65.

<sup>68</sup> Ton Notermans, *Money, Markets, and the State: Social Democratic Economic Policies since 1918*, Cambridge/New York 2007.

## 6. The End of Moderation

In 1985 the *Bundesbank* recorded the triumph of its anti-inflationary campaign. Inflation in the Federal Republic was at zero. Unfortunately, however, the loudly proclaimed logic of the Natural Rate of Unemployment cut both ways. If high inflation could not buy low unemployment, nor did low inflation yield noticeably better labor market outcomes. In Germany, widely seen as the strongest European economy, unemployment topped 9.3 percent, the highest since the dark days of postwar reconstruction. Undeterred by the signs of Eurosclerosis, in 1989 the Delors committee finalized plans for European Monetary Union. In a truly grand bargain, East and Western Europe were brought together around a unified Germany with the DNA of the *Bundesbank* injected into what would become the European Central Bank (ECB), a continent-wide monetary watchdog with a one-sided anti-inflation mandate and a mission to complete the harmonization of European capital markets in a world of capital mobility.

Not surprisingly, conservative German central bankers like Otmar Issing never tire of hammering home the world historical lesson: the conquest of inflation was the concomitant of the conquest of totalitarianism. In a speech delivered in Prague, 15 years after the end of the Cold War, he explained not only the need to protect money against politics, but also the crucial inverse link. “It is important to keep reminding ourselves of the fundamental link between inflation and the tendency towards collectivist solutions.”<sup>69</sup> Rather tastelessly given that his hosts were Czech he went on to remind his audience that “nothing rendered the German people so embittered, so full of hatred, so ready for Hitler as inflation”<sup>70</sup>. In a new age of Holocaust consciousness this was the ultimate argument. Inflation led to Auschwitz. And the only guarantee against inflation was an independent central bank.

One could forgive the *Bundesbank* its triumphalism. But by the 2000s its anti-inflationary old religion had come to sound both anachronistic and parochial. The narrative of the Great

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<sup>69</sup> Otmar Issing, “On the primacy of price stability. Prager-Frühlings-Vortrag,” Liberální Institut Prague, June 10, 2004. In another speech, from 1999, Issing recalls his experience of reading Hayek’s *The Road to Serfdom*. “Only eleven years after the Hitler regime and the war I suddenly started to understand the interdependence between totalitarianism and economic policy.” Otmar Issing, “Hayek. Currency competition and European Monetary Union. Annual Hayek Memorial Lecture hosted by the Institute of Economics affairs,” London, May 27, 1999.

<sup>70</sup> This was a quote from Stefan Zweig, *Die Welt von Gestern. Erinnerungen eines Europäers*, Frankfurt a.M. 1970, 359.

Moderation crafted by the research divisions of central banks around the world and top economics departments in the US was no less a narrative of historic triumph. But it was presented in cooler more technical tones. As the “Age of Extremes” was consigned to the past, the independent central bank was touted as a new type of governance aptly referred to as incorporating the “logic of discipline”<sup>71</sup>. Kydland and Prescott’s constitutional recommendation of policy delegation had risen to the rank of evidence-based wisdom. The robustness of a central bank’s independence was subject to practical and academic testing. The kinds of clashes between elected governments and “autonomous” central bankers that had defined the course of the political history of Europe between 1972 and 1983, were now so ritualized and formalized that they could be incorporated into quantitative databases. From Sweden to Japan, from Australia to Finland, from Spain to Canada – between 1989 and the mid-1990s more than two dozen countries decided to strengthen the independence of their respective central banks. Correlations quickly captured the reassuring pairing of a credible, assertive central bank and low-inflation<sup>72</sup>. Touring the world, Ben Bernanke, the wonk made monetary superhero, could reiterate that “careful empirical studies support the view that more-independent central banks tend to deliver better inflation outcomes than less-independent central banks”<sup>73</sup>.

The history of the 1970s was rewritten in light of the Great Moderation. The inflation had been unleashed by inattention to the monetary essentials and inappropriate interest rates that went back to the 1960s. Inflation had been conquered through intelligent institutional design and better policy<sup>74</sup>. In the age of the “cultural turn”, the history of the inflation that had once preoccupied both the public and policy-makers became a specialist domain for economists and economic historians rarely frequented by general historians. In the early 2000s, with the encouragement of

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<sup>71</sup> Alasdair Roberts, *The Logic of Discipline: Global Capitalism and the Architecture of Government*, Oxford 2010.

<sup>72</sup> Two of the earliest and most influential such papers were Alex Cukierman/Steven B. Webb/Bilin Neyapti, “Measuring the Independence of Central Banks and its Effects on Policy Outcomes,” in: *World Bank Economic Review* 6 (1992) H. 3, 353-398, and Alberto Alesina/Lawrence H. Summers, “Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence,” in: *Journal of Money, Credit and Banking* 25 (1993), 151-162.

<sup>73</sup> Ben S. Bernanke, “Central Bank Independence, Transparency, and Accountability,” at the Institute for Monetary and Economic Studies International Conference, Bank of Japan, Tokyo, May 25, 2010.

<sup>74</sup> Christina D. Romer/David H. Romer, “The Evolution of Economic Understanding and Postwar Stabilization Policy,” in: *Rethinking Stabilization Policy. A Symposium Sponsored by the Federal Reserve Bank of Kansas City*, Kansas City 2002, 11-78.



the NBER and the Fed, the noted monetarist and economic historian Michael D. Bordo and Athanasios Orphanides of the Massachusetts Institute of Technology and the Central Bank of Cyprus began planning a major academic conference to bring together new scholarship on the Great Inflation<sup>75</sup>. It was in every respect a characteristic product of the genre. It involved contributors from the US, Germany, New Zealand, Canada, Japan and Portugal, Sweden, Finland and the United Kingdom. A mixture of policy-makers current and retired, economists, economic historians and one recognized historian<sup>76</sup>.

But rather than putting an academic capstone on the narrative of the Great Moderation, the conference witnessed the throwing open of the entire history of the monetary and financial policies since 1973. The meeting convened with spectacular timing on 26-27 September 2008, only days after the Financial Crisis had reached its most critical point. Mervyn King, the Governor of the Bank of England had to cancel his attendance at short notice. A Vice President of the ECB who was scheduled to attend turned back at Frankfurt airport but emailed the response that he had prepared. Astonishingly, Don Kohn, then Vice Chairman of the Federal Reserve, made time to attend the final session. There are few historical conferences at which the participants are exposed to these pressures and would nevertheless consider the topic of such importance as to be worthy of a detour from Washington D.C. to Vermont.

Since September 2008, to prevent an implosion of the Atlantic financial economy, monetary aggregates have been run up. Public debts have surged to accommodate a rescue of the financial sector. By any historic standard the balance sheets of the Fed, the ECB, the Bank of Japan and the Bank of England should be setting course for a dramatic acceleration of inflation. And yet we face the prospect not of inflation but of deflation. We are in a weird and inverted world. The result has been a collapse of the anti-inflationary consensus assembled in the late 1970s. A fundamental clash has opened between market monetarists, supply-siders and “Austrians”. The IMF, BIS, Fed, ECB, Bank of England and the *Bundesbank* are at odds to an extent not seen since the 1970s.

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<sup>75</sup> Bordo/Orphanides (Eds.), *The Great Inflation*. The conference was held in Woodstock, Vermont.

<sup>76</sup> See the exemplary statement in Marvin Goodfriend/Robert G. King, “The Great Inflation Drift,” in: *ibidem*, 187.

The tone of the debate in the public sphere has been no less heated. In May 2011, in a lurid article in “Newsweek”, Niall Ferguson warned his American readers of a new Great Inflation. Ben Bernanke’s hugely expansive monetary policy, he argued, had been successful in staving off a great depression style deflation, but this left Ferguson warning that “we’ve avoided rerunning the 1930s only to end up with a repeat of the 1970s”<sup>77</sup>. Indeed, according to Ferguson the escape from the inflation of the 1970s may not have been real but a statistical artefact of 24 technical “improvements” to America’s official consumer price index since 1978. “If the old methods were still used,” Ferguson explained, “the CPI would actually be 10 percent. Yes, folks,” Ferguson announced in 2010, “double-digit inflation is back”. This prediction has not been confirmed by subsequent events. But the resistance to monetary experimentation is by no means confined to individual right-wing pundits. It is assiduously fostered by the *Bundesbank*. And in Germany at least it is shared also by parts of the left.

By contrast in the US it is anti-inflation politics itself that is under scrutiny. Paul Krugman in therapeutic mode remarked that there was no hope for those suffering from the “inflation paranoia” so “deeply embedded in the modern conservative psyche”. For the apocalyptic anti-inflationists, Krugman commented, time stands still. “It’s always the 70s, if not Weimar, and if the numbers say otherwise, they must be cooked.”<sup>78</sup> As if to confirm the suggestion, Ferguson added to his column a dose of autobiographical self-reflexivity, commenting to his readers that he “grew up in the 1970s. My first-ever publication, when I was 10, was a letter to the *Glasgow Herald* lamenting the soaring price of school shoes (I genuinely thought my feet were growing too fast). I wrote my Ph.D. dissertation about German hyperinflation. So perhaps I’m also hypersensitive.”<sup>79</sup>

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<sup>77</sup> Niall Ferguson, “The Great Inflation of the 2010s,” in: *Newsweek*, May 1, 2011; [www.newsweek.com/great-inflation-2010s-67663](http://www.newsweek.com/great-inflation-2010s-67663).

<sup>78</sup> Paul Krugman, “Understanding the Crank Epidemic,” in: *New York Times*, The Opinion Pages, July 17, 2014; <http://krugman.blogs.nytimes.com/2014/07/17/understanding-the-crank-epidemic>.

<sup>79</sup> Niall Ferguson, “The Great Inflation of the 2010s,” in: *Newsweek*, May 1, 2011. Already the opening gambit of Ferguson’s career was a staunch revisionist posture that sought to link the rise of Nazism to the hyperinflation of 1923, against the historiographical consensus that tended to emphasize the pernicious effects of deflation. Niall Ferguson, *Paper and Iron. Hamburg Business and German Politics in the Era of Inflation, 1897-1927*, Cambridge/New York 2002.

## 7. Captive Closure and Modernity

It is of course important to acknowledge one's location. We think, whether we admit it or not, from within traditions. But for those filiations not to become rigid ideological shackles it is important to reexamine the past that shapes us. Rather than expecting the present endlessly to repeat the "lessons learned" in the 1970s, we would surely be better occupied asking how the history of the Great Inflation, which as we have shown here was always already contentious, appears in new light given the upheaval of the Financial Crisis. If we view the relationship between present and past not as static repetition, but with a view to dynamic mutual reinterpretation, three fundamental revisions force themselves immediately on our attention. Rather than seeing the 1970s as the staging ground for the Great Moderation, it now seems that the transition from the inflationary 1970s to the 1980s set the stage for destabilizing financialization, a huge surge in inequality, and a form of globalization that threatens not just disinflation, but a new era of long-run deflation.

As 2014 began, Larry Summers, once one of the most triumphal spokesmen of the Washington consensus, performed a truly spectacular historical rewriting. In a series of speeches he declared that the decades since the 1980s that had once been heralded as the triumphant epoch of the "Great Moderation", had in fact consisted of a series of bubbles masking a steadily deteriorating long-run growth path<sup>80</sup>. Vast flows of capital were absorbed into the deflated western economies without generating better than trend growth. What we are left with after the crisis is huge leverage and flat investment. Given the vast debt levels that hang over both the private and public sectors the alternatives are stark. Austerity is the first response in Europe, which now risks provoking ever deeper deflation. But in international policy-making circles and in the US the slide into a spiral of low investment, stagnation and deflation has triggered for the first time since the 1980s a serious reevaluation of the priority of low inflation. The IMF has suggested targetting inflation well above the two percent level that established itself as the norm

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<sup>80</sup> Lawrence H. Summers, "U.S. Economic Prospects: Secular Stagnation, Hysteresis, and the Zero Lower Bound," in: *Business Economics* 49 (2014), 65-73; Lawrence H. Summers, "Reflections on the 'New Secular Stagnation Hypothesis'," in: Coen Teulings/Richard Baldwin (Eds.), *Secular Stagnation: Facts, Causes and Cures*, London 2014, 27-38.

during the Great Moderation<sup>81</sup>. Against the backdrop of the anti-inflationary struggles of the 1970s this is heresy and notably in Europe it has been met with howls of outrage from the *Bundesbank*. The conservative culture war against inflation goes on. And, as in the 1970s, there are no doubt powerful social interests who for reasons of their own are opposed to any more expansive policy stance. The question is whether under current conditions of unprecedentedly high private and public debt a strategy of redistributing the burden between debtors and creditors, investors and savers, young and old by means of inflation might not have a fighting chance.

Faced with the wall of austerian common sense that has dominated global policy-making since 2010, Paul Krugman has been driven to imagine a variety of alarming scenarios as the trigger necessary to shake America's capitalist democracy out of its deflationary slumber. In an inverted echo of Carter's appeal to Churchill in the battle against inflation, Krugman imagines a patriotic rally against an invading Martian space-fleet (or alternatively the Chinese) as the trigger for a Keynesian breakthrough<sup>82</sup>. Historians and political scientists may hope to contribute to the debate not through science fiction but through critically evaluating the evidence and theoretical arguments that underpin our views of the recent past. What is undeniable is that after 1973, with the collapse of Bretton Woods the world irrevocably entered a new age of fiat money. The first response in the 1970s, both in practical politics and social theory, was a profound and enlightening realization of the self-reflexivity of social and political organization. But the argument over inflation turned that in an unpredictable direction. Rather than relishing and exploring the freedoms of a new reflexive modernity, the lesson pounded home relentlessly since the anti-inflationary turn of 1979-1983 has been one of emphatic and persistence closure, a deeply institutionalized *Unmündigkeit*. It is a profound irony that 40 years on, the end of Bretton Woods and the advent of fiat money have given rise not to an expansion of our political alternatives but a remarkably pervasive conservatism and amnesia.

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<sup>81</sup> Laurence Ball, "The Case for a Long-Run Inflation Target of Four Percent," Washington D.C. 2014 (IMF Working Paper 14/92).

<sup>82</sup> In August 2011 Krugman was touting the idea of a war against Martians; [www.huffingtonpost.com/2011/08/15/paul-krugman-fake-alien-invasion\\_n\\_926995.html](http://www.huffingtonpost.com/2011/08/15/paul-krugman-fake-alien-invasion_n_926995.html). In February 2012 he gave a notorious interview to *Playboy* in which he stated that "Chinese policy right now is our enemy"; [www.workinglife.org/jonathan-tasinis-columns/playboy-interview-with-paul-krugman](http://www.workinglife.org/jonathan-tasinis-columns/playboy-interview-with-paul-krugman).